G-002/GR-92-1186 ORDER ADOPTING INTERIM RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Application of Northern States Power Company's Gas Utility for Authority to Change its Schedule of Gas Rates for Retail Customers Within the State of Minnesota

ISSUE DATE: December 31, 1992

DOCKET NO. G-002/GR-92-1186

ORDER ADOPTING INTERIM RATES

PROCEDURAL HISTORY

On November 2, 1992 Northern States Power Company's Gas Utility (NSP or the Company) filed a petition seeking a general rate increase of $14,873,000, or 5.83%, effective January 1, 1993.

As part of its filing, the Company proposed an interim rate schedule to be effective January 1, 1993 in the event that the Commission suspended its proposed final rate schedules.

On November 2, 1992, in a memorandum, the Commission asked interested persons to file comments on whether the Commission should accept the filing as substantially in compliance with applicable filing requirements and whether the matter should be referred to the Office of Administrative Hearings for contested case proceedings.

The Department of Public Service (the Department) filed comments which recommended accepting the filing and referring the matter for contested case proceedings. The Department was the only party to comment.

On December 14, 1992 the Commission issued its Order Accepting Filing and Suspending Rates in the matter.

On December 21, 1992, the Commission met to consider the Company's proposed interim rates.

FINDINGS AND CONCLUSIONS

The Company Proposal

NSP requested that its interim rate schedules go into effect as interim rates on January 1, 1993. The Company sought a rate increase of $12,643,000 or 4.96 percent based on the following financial summary:

NSP'S INTERIM RATES PROPOSAL

	(000 omitted)
Rate Base	$214,150
Operating Revenues including AFUDC	259,225
Operating Expenses	245,487
Operating Income including AFUDC	13,738
Rate of Return	9.93%
Operating Income Requirement	21,265
Income Deficiency	7,526
Revenue Conversion Factor	1.679825
Revenue Deficiency	$12,643
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The Interim Rate Statute

Minn. Stat. § 216B.16, subd. 3 (1990) states in part as follows:

> Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design. (Emphasis added.)

NSP's most recent rate proceeding was In the Matter of the Petition of Northern States Power Company for Authority to Change its Schedule of Rates for Gas Utility Service Within the State of Minnesota, filed on March 26, 1986. The Commission's FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER in that matter was issued on January 27, 1987 in Docket No. G-002/GR-86-160. The ORDER AFTER RECONSIDERATION was issued on April 1, 1987. This Order will refer to that proceeding as the Company's 1986 gas rate case. As required by Minn. Stat. § 216B.16, subd. 3 (1990), the interim rate factors proposed by NSP at this time (rate base, rate of return, and rate design) must be compared with the factors adopted by the Commission for NSP in that previous proceeding to determine whether they are, as required by the statute, unchanged or of the same nature and kind as those adopted in that proceeding.

A. Rate Base

1. Rate Base Items Generally

In its interim rates filing for the test year ending December 31, 1993, NSP proposed a rate base of $214,150,000. The interim rates statute provides that unless exigent circumstances exist, interim rates shall be calculated using the rate base proposed by the Company, provided that the rate base items must be the same in nature and kind as those allowed in the utility's most recent rate proceeding. Minn. Stat. § 216B.16, subd. 3 (1990).

The Commission has reviewed all items that NSP has proposed as components of its interim rate base in light of that statute and finds that they are acceptable except with respect to the proposed inclusion of gas storage carrying costs. That issue will be discussed below. In addition, NSP's proposal regarding tax benefit transfers (TBTs) requires a specific Commission finding of exigent circumstances and, therefore, must be discussed separately.

2. Gas Storage Inventory Costs

In its prior rate case, one of categories in NSP's rate base was Gas in Storage. In that case, the Gas in Storage category consisted of two components: liquified petroleum gas (LPG) and liquified natural gas (LNG) in aboveground storage. In the current case, the Company proposed to add a third component to the Gas in Storage category: natural gas in underground storage in the amount of $7,653,000. Together, the three components total $12,517,000.

This new component may be of the same in kind and nature as the liquid propane gas (LPG) and liquid nitrogen gas (LNG) costs approved for inclusion in the rate base in the previous case. However, the Commission has already provided the Company a specific method to earn a return on the value of that asset. In a previous docket, the Company requested and the Commission granted a variance to allow the Company to recover the carrying cost for its natural gas in underground storage through the purchased gas adjustment (PGA) clause. <u>In the Matter of a Petition from Northern States Power Company for a Variance to the Purchase Gas Charges, Automatic Adjustment Rule for Recovery of Carrying Costs Associated with Gas Storage Service</u>, Docket No. G-002/M-90-630, ORDER GRANTING VARIANCE FOR ONE YEAR (April 4, 1991). Moreover, in a subsequent Order reviewing and renewing that variance request, the Commission stated that the Company would continue to recover those costs through the PGA until such time as issues regarding gas storage carrying costs have been fully resolved in the Company's next rate case. See <u>In the Matter of a Petition from Northern States Power Company for a Variance to the Purchase Gas Charges, Automatic Adjustment Rule for Recovery of Carrying Costs Associated with Gas Storage Service</u>, Docket No. G-002/M-90-630, ORDER EXTENDING VARIANCE AND SETTING FILING REQUIREMENTS (December 10, 1991).

In light of the Commission's Order establishing the duration of the variance and the Company's acceptance of the benefits of that decision and failure to request reconsideration of that Order, the Company's proposal to include underground gas storage inventory costs in the rate base for interim rates is inappropriate. Accordingly, the statute's exigent circumstances requirement is met and the Commission will require the Company to remove those costs, thereby reducing the proposed interim rate base by $7,653,000.

3. Tax Benefit Transfers

NSP's inclusion of Tax Benefit Transfers (TBTs) in its test year revenues reduces the Minnesota jurisdictional revenue requirement by approximately $870,000 on an annual basis.

There was no consideration given to TBTs in its last gas rate case, however, so TBTs are clearly not of the same kind and nature as items approved in that case. In the absence of exigent circumstances, they would have to be removed from calculation of interim rates. In this case, the Commission finds that exigent circumstances warrant the inclusion of the TBT revenue, as proposed by the Company.

Tax Benefit Transfers (TBTs) were acquired by NSP in the mid-1980s. The Commission established the sharing of economic benefits from TBTs with electric ratepayers in NSP's 1987 electric rate case (Docket No. E-002/GR-87-670). In the current gas rate case filing, NSP followed an allocation procedure which is consistent with the methodology established in the 1987 electric docket as well as with the decision in NSP's 1991 electric rate case, Docket No. E-002/GR-91-001. In addition, inclusion of TBT's is proposed by the Company and is clearly to the benefit of ratepayers. It is appropriate to recognize and give effect to treatment of TBTs that complies with previous Commission directives regarding them.

B. Income Statement

1. Income Statement Items Generally

For interim rates, NSP proposed a test year net income of $13,738,000. The Commission has reviewed all items that NSP has proposed as components of its interim income statement and finds that they are acceptable except with respect to its incentive pay plans and level of purchased gas costs. These issues will be discussed separately. In addition, the Company's proposal regarding flexible rate revenue, though accepted, warrants separate discussion.

2. Incentive Pay Plans

In NSP's most recent gas rate case (the 1986 gas rate case, Docket No. G-002/GR-86-160), the only incentive plan approved was a plan for its executive group. At this time, NSP has incentive pay plans covering the bargaining unit, the non-bargaining unit in grades 1-12 and management, as well as for its executives. In its interim rates filing in this docket, the Company included costs of the incentive pay plans for all these worker groups totaling $995,000 and $75,000 for related retirement expense. The Company stated that it has redesigned its incentive plans to achieve a greater customer-oriented focus and views these plans simply as part of a total compensation package for its employees.

The Commission finds that incentive plans are different in nature and kind from traditional employee compensation packages and that the currently proposed plans are different in nature and kind from the Executive Annual Plan approved in the previous gas rate case. The scope of these plans is significantly more comprehensive than what was approved in the 1986 rate case and the bases on which the incentives are awarded are also different.

Accordingly, the Commission will require NSP to remove the costs associated with its incentive plans from the calculation of its interim rates, $995,000 plus $75,000 in retirement related expenses.

3. Revenues From Flex-Rate Customers

In its interim rates filing, NSP projected revenues from flexible transportation customers at $1,745,102 which was based on projected discounts of $222,520 from the revenues which would be generated from the same consumption levels using standard non-flex rates. The Commission finds that the discounts used by NSP in its interim rates filing are appropriate. The level of flexible rate revenue, of course, remains an issue that the parties will consider in the hearing process.

4. Purchased Gas Costs

In its interim rates filing, NSP proposed a purchased gas expense of $167,864,000. However, the Company's calculation of interim rates was based on gas costs of $166,839,000, which causes revenues to be understated by $1,025,000.

This discrepancy could be corrected 1) by increasing the revenues by $1,025,000 or 2) by reducing the purchased gas cost by the same amount. If the former method were chosen, NSP would have to refile its new base cost of gas filing which was based on the present rates calculation. The more efficient method would be to simply adjust the purchased gas cost. This results in the same level of gas costs used for calculating revenues, purchased gas expense, and the base cost of gas. Since the end result for the Company and the ratepayer is the same in the end, the Commission will adopt the more efficient method and reduce the purchased gas cost by $1,025,000.

C. Interim Rate of Return

1. Return on Common Equity

NSP proposed a rate of return on common equity of 12.16 percent for interim rates. This figure, as required by the interim rates statute, is the same as that allowed by the Commission in the last rate case. Minn. Stat. § 216B.16, subd. 3 (1990).

2. Capital Structure

NSP has proposed an equity ratio of 48.50 percent, a substantial increase from the 45 percent equity ratio that the Commission approved for the Company in its most recent gas rate case. The statutory requirement of basing interim rates on the proposed test year cost of capital does not include accepting the precise mix of capital sources proposed by the Company.

In its December 29, 1992 ORDER SETTING INTERIM RATES in Docket No. E-002/GR-89-865, the Commission stated:

> As the Commission explained in the Company's last interim rates Order [Docket No. E-002/GR-87-670], that requirement applies to the costs assigned to various sources of capital, not to the balance between the sources of capital themselves. To hold otherwise would allow the Company to circumvent important policy decisions carefully reached after full contested case proceedings. It would seriously impair the Commission's ability to carry out its supervisory functions over public utilities. It would adversely affect the public interest by allowing rates to be calculated on the basis of a capital structure the Commission has found to be unjust and unreasonable for ratemaking purposes.

Equity is the most expensive means of financing a utility and always receives careful scrutiny in general rate proceedings. The Commission finds no reason to adopt the Company's major departure from equity ratios previously approved by the Commission following full rate case proceedings. The Commission believes that in this case it is preferable to maintain the currently approved equity ratio prior to full examination of the issue in the main case.

For these reasons, the Commission will not approve the Company's proposed capital structure and will instead base interim rates on the 45 percent equity ratio approved in the last rate case. This is not the first time that the Commission has found NSP's proposed equity ratio unacceptable. In this Order, the Commission makes the same correction to the Company's equity ratio that it adopted in two previous NSP electric rate cases: E-002/GR-87-670 and E-002/GR-89-865.

With respect to the disallowed equity portion (3.5 percent), the Commission will treat it the same way it treated the disallowed portion of the equity ratio in the Company's 1986 gas rate case. The Commission will reclassify that 3.5 percent as long term debt and apply a current cost of long-term debt (the 5.875 percent coupon rate on NSP's first mortgage bond issue of October 19, 1992) to the 3.5 percent disallowed equity. The resulting overall return will be 9.71 percent.

D. Interim Rate Design

The interim rate increase must be allocated to customer classes in a manner which will not change the existing rate design. Interim rates should consist of the existing rate schedules with an interim adjustment equal to the overall requested interim increase percentage.

NSP proposed to collect its interim rate increase by applying an equal percentage increase to the non-gas revenues, or margin, for each class of customers. After calculating the resulting dollar increase for a given customer class, the Company would calculate a surcharge which would generate the same amount from each class. Under this method, the resulting surcharge varies from class to class, depending on the size of the margin.

The Commission has examined NSP's proposed method for allocating the increase among customer classes and finds that it does not change the existing rate design. The structure of the individual rate schedules is maintained, as is the relationship among the total margins paid by the various customer classes. In addition, this method allows any refunding that may become necessary to be made by simply lowering the surcharge percentage by the amount appropriate for a given class. The Commission will approve it.

Commission Action

Based on the findings and conclusions above, the Commission will authorize an interim revenue increase of $8,386,000 or 3.29 percent of revenues under current rates, for NSP. The interim rate schedule will be effective for all consumption beginning January 1, 1993.

Interim rates are collected subject to refund in the event the interim rate level exceeds the final rate level allowed in the general rate case. Minn. Stat. § 216B.16, subd. 3 (1988).

ORDER

1. Northern States Power Company is authorized to collect $8,386,000 in additional annual revenues, or 3.29 percent of revenues under current rates. The interim rate schedule will be effective on January 1, 1993.

2. Within seven days of the date of this Order, the Company shall file with the Commission and the Department of Public Service interim tariff sheets and supporting documentation reflecting the decisions herein.

3. The Company shall provide notice of rate changes with the first billing under interim rates.

4. The Company shall keep such records of sales and collections under interim rates as will be necessary to compute a potential refund. Any refund shall be made within 120 days of the effective date of the Commission's final Order in a manner approved by the Commission.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)